

Message Text

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FM AMEMBASSY ROME

TO SECSTATE WASHDC IMMEDIATE 1637

TREASURY DEPT WASHDC IMMEDIATE

C O N F I D E N T I A L SECTION 1 OF 2 ROME 19891

LIMDIS

TREASURY PASS WIDMAN

E.O. 11652: GDS

TAGS: EFIN, IT

SUBJ: STATUS OF STABILIZATION PROGRAM

REF: ROME 19783

1. SUMMARY. ON DECEMBER 6 EMBOFFS CALLED ON HEAD OF RESEARCH OFFICE OF BANK OF ITALY, DR. ANTONIO FAZIO, TO SEEK CLARIFICATION OF CURRENT GOI ESTIMATE OF 1977 TREASURY CASH DEFICIT IN VIEW OF RECENT DEBATE ABOUT 1977 BUDGET EXPENDITURES WHICH ALLEGEDLY CANNOT BE COVERED BY REVENUE MEASURES TAKEN TO DATE. FAZIO ASSERTED THAT GOI TREASURY CASH DEFICIT ESTIMATE FOR 1977 IS STILL ABOUT 10,000 BILLION LIRE. HE EXPLAINED THAT CURRENT GOI EXPENDITURE ESTIMATES ALREADY INCLUDE VIRTUALLY ALL ITEMS FOR WHICH CRITICS CLAIM FINANCING IS NOT AVAILABLE. HOWEVER, EMBASSY BELIEVES THAT THERE COULD BE POTENTIAL UNCOVERED EXPENDITURES OF MAXIMUM OF 3,300 BILLION LIRE. REGARDING REDUCTION IN LABOR COSTS, EMBASSY'S ROUGH GUESS IS TH AT ABOUT 2,700 BILLION LIRE IN REDUCED LABOR COSTS OF BUSINESS SECTOR MAY BE ACHIEVED. END SUMMARY.

2. PUBLIC SECTOR DEFICIT. IN RESPONSE TO EMBOFF QUESTIONS ABOUT STATUS OF BUDGET DEFICIT IN 1977, FAZIO INITIALLY STRESSED THAT DEFICIT OF ENTIRE PUBLIC SECTOR, PARTICULARLY
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DEFICIT ON CURRENT OPERATIONS, WOULD BE SHARPLY REDUCED IN 1977 (TABLE 1). HE STRESSED THAT, FROM MACROECONOMIC

POINT OF VIEW, BROAD CONCEPT OF PUBLIC SECTOR DEFICIT WAS MORE IMPORTANT THAN SOMEWHAT MORE LIMITED CONCEPT OF TREASURY CASH DEFICIT USED BY IMF AND EC FOR ESTABLISHING LOAN CONDITIONS. FURTHERMORE, ESTIMATED DEFICIT ON CAPITAL OPERATIONS OF PUBLIC SECTOR OF 7,000 BILLION LIRE MIGHT VERY WELL BE TOO HIGH, GIVEN HISTORIC INEFFICIENCIES OF PUBLIC ADMINISTRATION IN EXPENDING CAPITAL BUDGET APPROPRIATIONS. (TABLE 1 INCLUDES ACTUAL DATA FOR 1975 TAKEN FROM BANK OF ITALY ANNUAL REPORT, WHICH SHOULD BE ROUGHLY COMPARABLE WITH 1976 AND 1977 ESTIMATES.)

3. TABLE 1 - PUBLIC SECTOR DEFICIT (BILLIONS OF LIRE)

	1975	1976E	1977E
CURRENT OPERATIONS	5,907	5,000	2,500
CAPITAL OPERATIONS	7,366	5,500	7,000
TOTAL	13,273	10,500	9,500

E - ESTIMATE

4. TREASURY CASH DEFICIT. FAZIO INDICATED THAT CURRENT ESTIMATES OF TOTAL TREASURY CASH DEFICIT FOR 1976 AND 1977 ARE 14,600 BILLION LIRE AND 10,100 BILLION LIRE, RESPECTIVELY. (THIS IS DEFINITION USED BY EC AND IMF FOR CASH DEFICIT BUT MUST BE REDUCED BY THE AMOUNT OF TREASURY CONTRIBUTIONS TO SPECIAL CREDIT INSTITUTES IN ORDER TO ARRIVE AT CEILING ON TOTAL CREDIT TO TREASURY.) FOR COMPARATIVE PURPOSES, TABLE 2 SHOWS ACTUAL 1975 DATA AND ESTIMATES FOR 1976 AND 1977. (1976 DATA, EXCEPT FOR FIGURES FOR TOTAL DEFICIT AND CREDIT TO TREASURY, ARE ROUGH ESTIMATES MADE BY EMBASSY ON BASIS ACTUAL DATA FOR FIRST EIGHT MONTHS OF YEAR. ESTIMATES FOR 1977 WERE OBTAINED FROM BANK OF ITALY JUST AFTER DECEMBER 4 MEETING.) NOTE THAT TABLE 2 CONTAINS ADJUSTMENT ITEM FOR CONSOLIDATION OF HEALTH INSURANCE FUND AND MUNICIPAL DEBTS BY THE TREASURY. FAZIO TOLD EMBASSY THAT BOTH EC AND IMF WILL AGREE TO EXCLUDE TREASURY EXPENDITURES FOR DEBT CONSOLIDATION FROM CEILINGS ESTABLISHED BY EC AND IMF SINCE ASSUMPTION OF DEBT DOES NOT CONSTITUTE NEW DEFICITS. (SEE COMMENT BELOW ON QUESTION OF INTEREST COSTS TO TREASURY OF SUCH DEBT CONSOLIDATION.)

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5. TABLE 2 - TREASURY CASH DEFICIT (BILLIONS OF LIRE)

	1975	1976E	1977E
CENTRAL GOVERNMENT			
RECEIPTS	23,893	32,500	42,100
EXPENDITURES	34,105	43,000	58,600
(OF WHICH DEBT CONSOL.)	(2,393)	(400)	(6,900)
BALANCE	-10,213	-10,500	-16,500
MINOR TREASURY OPERATIONS			

DEPOSIT AND LOAN FUND	-6351	-4,500	-6000
AUTONOMOUS ENTITIES			
GROSS DEFICIT	-16,564	15,000	-17,000
LESS DEBT CONSOLIDATION	2,393	400	6,900
NET DEFICIT	-14,171	-14,600	-10,100
LESS: TREASURY CONTRIB.			
TO SPECIAL CREDIT INST.	406	800	300
CREDIT TO TREASURY	-13,765	-13,800	-9,800

6. ALLEGED UNCOVERED EXPENDITURES IN 1977. AS REPORTED REFTEL, THERE HAS BEEN DEBATE IN ITALIAN PRESS IN RECENT DAYS ABOUT WHETHER REQUIREMENTS OF TREASURY IN 1977 WILL BE INCREASED BY A NUMBER OF EXPENDITURES NOT CURRENTLY ACCOUNTED FOR. PRESS PUBLISHED LIST OF EXPENDITURES FOR WHICH LABOR UNIONS SOUGHT CLARIFICATION IN THEIR MEETING WITH GOVERNMENT ON DECEMBER 4 IN ORDER TO DETERMINE WHETHER FINANCING WOULD, IN FACT, BE AVAILABLE FOR ALL THESE ITEMS. TABLE 3 SHOWS COMPILATION OF EXPENDITURE ITEMS BY UNIONS AND EMBASSY ATTEMPT TO RECONSTRUCT CAMPARABLE DATA OBTAINED DURING TALK WITH FAZIO. NOTES TO EACH ITEM IN TABLE EXPLAIN EMBASSY UNDERSTANDING OF WHETHER OR NOT GOI TREASURY CASH DEFICIT FIGURES IN TABLE 2 EXPLICITLY OR IMPLICITLY INCLUDE THESE POSSIBLE EXPENDITURES.

7. TABLE 3 - POSSIBLE ADDITIONAL EXPENDITURES IN 1977 (BILLIONS OF LIRE).

	UNIONS	BOI
A. PENSIONS	2,000	2,150
B. HEALTH INSURANCE FUNDS		
(DEBT CONSOLIDATION)	1,500	1,400
C. LOCAL GOVERNMENT		
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(DEBT CONSOLIDATION)	2,000	5,500
D. CAPITAL ENDOWMENT FUNDS	2,000	500
E. PUBLIC EMPLOYEES' WAGE CONTRACT	1,000	700
F. MONTEDISON/MONTEFIBRE	500	-
G. FISCALIZATION OF SOCIAL COSTS	1,000	550
H. HOUSING, YOUTH EMPLOYMENT,		
FOOD AND AGRICULTURE	760	600
I. INDUSTRIAL RECONVERSION	-	100
TOTAL	10,650	11,500

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ACTION EUR-08

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TO SECSTATE WASHDC IMMEDIATE 1650

TREASURY DEPT WASHDC IMMEDIATE

C O N F I D E N T I A L SECTION 2 OF 2 ROME 19891/2

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8. FOLLOWING ARE EXPLANATORY NOTES TO TABLE 3 KEYED TO EACH LINE ITEM:

A. WOULD INCLUDE 300-400 (ASSUME 350) BILLION LIRE IN CENTRAL GOVERNMENT EXPENDITURE FOR GOVERNMENT EMPLOYEES WHICH ARE LINKED TO SCALA MOBLE INCREASES. ALSO INCLUDES ABOUT 1,800 BILLION POSSIBLE FINANCING OF OTHER PAYMENTS OWED BY INPS (SOCIAL SECURITY INSTITUTE) WHICH CANNOT BE COVERED BY CONTRIBUTIONS. (ASSUMPTION OF ANY OF THIS COST BY TREASURY WOULD APPEAR IN " MINOR TREASURY OPERATIONS" IN TABLE 2.)

B. ESTIMATE OF 1,400 BILLION LIRE IS STILL PRELIMINARY. THIS ITEM IS EXCLUDED FROM IMF/EC CEILINGS SINCE SHORT-TERM DEBT MAINLY TO COMMERCIAL BANKS WILL BE REPLACED BY NEW MEDIUM-TERM TREASURY SECURITIES. ASSUMPTION OF PORTION OF INTEREST PAYMENTS BY TREASURY ARE APPARENTLY NOT EXPLICITLY INCLUDED IN TREASURY CASH DEFICIT. AT 14 PERCENT, THIS COULD AMOUNT TO 195 BILLION LIRE.

C. SHORT-TERM LOCAL GOVERNMENT DEBT TO BE CONSOLIDATED IS IN RANGE 5,00 TO 6,00 BILLION LIRE, UBT ITEMS IS EXCLUDED FROM IMF/EC CEILINGS AS IN CASE OF B. ABOVE. NET INTEREST COST TO TREASURY COULD BE ABOUT 220 BILLION LIRE (14 PERCENT RATE ON BONDS WITH PROCEEDS RELOANED TO LOCAL GOVERNMENTS AT 10 PERCENT.)

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D. BOI FIGURE FOR CAPITAL ENDOWMENT FUND INCLUDES ONLY ENEL. UNIONS BELIEVE THAT OTHER STATE HOLDING COMPANIES WILL DEMAND CAPITAL ENDOWMENT CONTRIBUTIONS FROM GOI (GEPI,

EGAM AND IRI, FOR EXAMPLE).

E. BOI BELIEVES THAT ONLY 250 BILLION LIRE COST OF WAGE CONTRACT INCREASES FOR CENTRAL GOVERNMENT EMPLOYEES SHOULD BE INCLUDED ON GROUNDS THAT: (A) SOME OTHER NON-CENTRAL GOVERNMENT PUBLIC SECTOR EMPLOYEES HAVE ALREADY RECEIVED INCREASES; (B) GOI MAY NOT CONCEDE SIMILAR INCREASES TO EMPLOYEES IN OTHER PARTS OF PUBLIC SECTOR; AND (C) GOI MAY NOT BE RESPONSIBLE FOR TOTAL FINANCING BURDEN EVEN IF INCREASES ARE GRANTED. HOWEVER, BOI SEEMS TO HAVE OVERALL SALARY COST FIGURE IN MIND OF ABOUT 700 BILLION LIRE.

F. NO PROVISION HAS BEEN MADE FOR GOI PARTICIPATION IN POSSIBLE CAPITAL INCREASE OF MONTEDISON, WHICH IS PARTLY OWNED BY THE STATE HOLDING COMPANIES (ENI AND IRI).

G. IT IS AGREED AMONG THE GOI, THE UNIONS AND CONFINDUSTRIA THAT ANY FISCALIZATION OF SOCIAL COSTS NOW BORNE BY BUSINESS WILL BE FINANCED BY NEW TAX REVENUES, EITHER BY VALUE ADDED TAX OR BY INCOME TAX RISE. THEREFORE, THIS WILL NOT AFFECT TREASURY CASH DEFICIT.

H. BOI DID NOT GIVE BREAKDOWN OF THESE THREE COMPONENTS. UNIONS FIGURES ARE, RESPECTIVELY: 150, 400 AND 200 BILLION LIRE.

I. BOI TOTAL FIGURE FOR INDUSTRIAL RECONVERSION IS 600 BILLION LIRE, BUT THIS INCLUDES 500 IN CAPITAL ENDOWMENT FUND CONTRIBUTIONS SHOWN IN D. ABOVE.

9. POTENTIAL UNCOVERED ADDITIONAL EXPENDITURES. TABLE 4 PRESENTS EMBASSY'S CONCLUSIONS AS TO WHICH ITEMS LISTED IN TABLE 3 MAY NOT HAVE BEEN ADEQUATELY PROVIDED FOR IN CURRENT GOI TREASURY CASH DEFICIT ESTIMATE FOR 1977. DATA IN FIRST COLUMN OF TABLE ARE MEANT TO APPROXIMATE OUTSIDE LIMIT OF POTENTIAL UNCOVERED EXPENDITURES. FOR EXAMPLE, UNION'S ALLEGATIONS THAT AN ADDITIONAL 1,500 BILLION LIRE WILL BE NEEDED TO COVER CAPITAL ENDOWMENT FUND CONTRIBUTIONS

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TO STATE HOLDING COMPANIES SEEMS QUITE HIGH. HIGHEST PREVIOUS ANNUAL FIGURE FOR TOTAL CONTRIBUTIONS TO THESE HOLDING COMPANIES WAS 895 BILLION LIRE IN 1973. WHILE IT IS QUITE POSSIBLE THAT 500 BILLION CONTRIBUTION FOR ENEL ALONE MAY NOT BE SUFFICIENT, TOTAL CONTRIBUTIONS OF 2,00 BILLION LIRE DO NOT SEEM LIKELY. CAPITAL INCREASE BY MONTEDISON MAY OR MAY NOT MATERIALIZE. EVEN IF THERE IS CAPITAL INCREASE, SUBSCRIPTION WOULD MAINLY BE RESPONSIBILITY OF ENI. COST OF PUBLIC EMPLOYEES' WAGE CONTRACTS WITH PUBLIC SECTOR AGENCIES OTHER THAN CENTRAL

GOVERNMENT ADMINISTRATION MAY OR MAY NOT BE APPROVED DURING CURRENT WAGE NEGOTIATIONS AND MAY, BUT NEED NOT, BE FINANCED BY THE TREASURY DEPENDING UPON THE FINANCIAL CAPACITY OF THE VARIOUS AUTONOMOUS ENTITIES, LOCAL GOVERNMENTS AND OTHER AGENCIES TO MEET ADDITIONAL WAGE COSTS. THE ITEM FOR INTEREST ON CONSOLIDATED DEBTS OF HEALTH INSURANCE FUNDS AND LOCAL GOVERNMENTS IS INCLUDED IN TABLE 4 SINCE FAZIO WAS RATHER VAGUE ABOUT WHETHER OR NOT GOI EXPENDITURE ESTIMATES EXPLICITLY PROVIDED FOR COST OF TREASURY'S ASSUMPTION OF INTEREST PAYMENTS ON THESE DEBTS AND IN WHAT AMOUNT. FAZIO DID POINT OUT CORRECTLY THAT INTEREST RATE COSTS OF THESE DEBTS TO ENTIRE PUBLIC SECTOR WOULD ACTUALLY BE REDUCED SINCE TREASURY SECURITIES WILL BEAR LOWER RATE OF INTEREST THAN PRESENT HIGH COST OF COMMERCIAL BANK CREDIT OUTSTANDING WITH THESE DEBTORS. EVEN IF TOTAL POTENTIAL UNCOVERED EXPENDITURES OF MORE THAN 2,700 BILLION LIRE DO NOT MATERIALIZE IN 1977, STILL LEGITIMATE QUESTIONS CAN BE RAISED AS TO WHETHER ADEQUATE PROVISION HAS BEEN MADE IN GOI ESTIMATES FOR AT LEAST SOME OF THESE EXPENDITURES. IF PROBLEM SHOULD, INDEED, MATERIALIZE, SECOND COLUMN OF TABLE 4 IS MEANT TO SHOW AMOUNT OF POSSIBLE UNCOVERED 1977 EXPENDITURES WHICH IN EMBASSY JUDGMENT MIGHT MORE LIKELY OCCUR. HOWEVER, EVEN THIS FIGURE IS ONLY A ROUGH GUESS.

10. TABLE 4 - POTENTIAL UNCOVERED ADDITIONAL EXPENDITURES IN 1977 (BILLIONS OF LIRE)

	"MAXIMUM"	"MORE LIKELY"
CAPITAL ENDOWMENT FUNDS	1,500	500
PUBLIC EMPLOYEES' WAGE CONTRACTS	450	350
MONTEDISON/MONTEFIBRE	400	400
INTEREST ON CONSOLIDATED DEBTS	415	415
TOTAL	2,765	1,665

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11. POSSIBLE LABOR COST MEASURES. TABLE 5 SHOWS EMBASSY'S CURRENT BEST GUESS ABOUT PROSPECTS FOR OBTAINING REDUCTION IN LABOR COST TO BUSINESS. IT IS ASSUMED THAT GOI'S PARTIAL BLOCK OF SCALA MOBILE WAGE ADJUSTMENTS AFFECTING WAGE AND SALARY EARNERS WITH INCOMES ABOVE 6 MILLION LIRE PER YEAR WILL BE RATIFIED AND WILL RESULT IN REDUCTION IN LABOR COSTS OF 600 BILLION LIRE (A BOI ESTIMATE). IT IS FURTHER ASSUMED THAT GOI WILL DECIDE TO RECHANNEL THESE FUNDS BACK TO BUSINESS SECTOR IN SOME WAY. (IT HAS NOT BEEN COUNTING THIS FIGURE AS A RECEIPT IN ITS PACKAGE OF TAX AND TARIFF MEASURES.) PROSPECTS APPEAR FAIRLY GOOD THAT LABOR UNIONS WILL EVENTUALLY AGREE TO AT LEAST TEMPORARY CHANGE IN FREQUENCY OF SCALA MOBILE ADJUSTMENTS FROM QUARTERLY TO SEMI-ANNUALLY. BOI ESTIMATES THAT THIS WOULD RESULT IN GROSS CUT OF ABOUT 1,500 BILLION LIRE IN LABOR COSTS. HOWEVER, THIS MEASURE WOULD OVERLAP PARTIAL BLOCK. EMBASSY ESTIMATES THAT NET

BENEFIT FROM CHANGE TO SIX MONTH ADJUSTMENT WOULD BE ABOUT 1,350 BILLION LIRE. FINALLY, IT IS ASSUMED THAT SOME FISCALIZATION OF SOCIAL COSTS TO BUSINESS WILL BE AGREED TO. EMBASSY HAS SIMPLY SPLIT THE DIFFERENCE BETWEEN REPORTED GOI FUTURE OF 500 TO 600 BILLION LIRE AND REPORTED UNION ESTIMATE OF 1,000 BILLION LIRE. CONFINDUSTRIA, ON OTHER HAND, INITIALLY WAS PRESSING FOR 3,000 BILLION LIRE OR MORE. IN ADDITION TO THESE THREE MEASURES, SOME AGREEMENTS MAY BE REACHED ON PRODUCTIVITY QUESTIONS WHICH IN LONG RUN COULD PROVE TO BE IMPORTANT BUT WHICH ARE DIFFICULT TO QUANTIFY AND ARE, THEREFORE, NOT INCLUDED IN TABLE T.

12. TABLE 5 - POSSIBLE LABOR COST MEASURES (BILLIONS OF LIRE)

PARTIAL BLOCK OF SCALA MOBILE	600
SEMI-ANNUAL SCALA MOBILE ADJUSTMENT (NET)	1,350
FISCALIZATION OF SOCIAL COSTS	750
TOTAL	2,700 BEAUDRY

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